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Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-1839

ASARCO INCORPORATED (formerly The American Smelting and Refining Company), *Appellant,*

v.

IDAHO STATE TAX COMMISSION, *Appellee.*

On Appeal from the Supreme Court of Idaho

APPENDIX TO JURISDICTIONAL STATEMENT

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APPENDIX A

IN THE SUPREME COURT OF THE STATE OF IDAHO

No. 12198

Boise term, December 1977

Filed: March 12, 1979

AMERICAN SMELTING & REFINING CO., *Plaintiff-respondent,*

v.

IDAHO STATE TAX COMMISSION, *Defendant-appellant.*

Appeal from the District Court of the Fourth Judicial District of the State of Idaho, Ada County. Hon. Marion J. Callister, District Judge.

Appeal from apportionment of income for Idaho state income tax purposes. *Reversed and remanded.*

David Leroy, Attorney General; Theodore V. Spangler, Jr., Deputy Attorney General for State Tax Commission, Boise, Idaho, for appellant.

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BAKES, J.

This appeal involves state income tax deficiencies assessed against the plaintiff respondent American Smelting

and Refining Company (ASARCO) by the defendant appellant Idaho State Tax Commission (Commission). The principal issues concern the apportionment of ASARCO's income from tangible and intangible property as "business income" under the Idaho version of the Uniform Division of Income for Tax Purposes Act (UDITPA).

I

THE FACTUAL BACKGROUND

In 1965 Idaho adopted with slight modification the Uniform Division of Income for Tax Purposes Act (UDITPA). I.C. § 63-3027. The Act contains rules for determining the portion of a corporation's total income from a multistate business which is attributable to this state and therefore subject to Idaho's income tax. In general, UDITPA divides a multistate corporation's income into two groups: business income and non-business income. Business income is apportioned according to a three factor formula, I.C. § 63-3027(i), while non-business income is allocated to a specific jurisdiction. I.C. § 63-3027(d)-(h). Idaho modified UDITPA to provide that "a parent and subsidiary corporation may, when necessary to accurately reflect income, be considered a single corporation." I.C. § 63-3027(s).

ASARCO is a multistate-multinational corporation primarily engaged in mining, smelting and refining nonferrous metals. ASARCO owns stock in several domestic and foreign corporations, most of which are engaged in similar or related operations. ASARCO's commercial domicile is in New York. Its Idaho activities include the operation of two mines, the Page Lead Zinc Mine and the Galena Silver Mine, and the location of its northwest mining department headquarters in Wallace, Idaho. ASARCO also sells in Idaho small amounts of secondary metals—metals reclaimed from scrap metal.

In 1971 the Multistate Tax Commission (MTC) completed a joint audit of ASARCO on behalf of Idaho and five other states. The MTC is the administrative agency of the Multistate Tax Compact, of which Idaho is a member. I.C. § 63-3701. Article VIII of the compact authorizes the MTC to perform interstate audits on behalf of member states. Idaho statutes specifically authorize the Idaho State Tax Commission to participate in such joint audits. I.C. § 63-3707. The constitutionality of the Multistate Tax Compact, including its joint audit provisions, has been upheld. United States Steel Corp. v. Multistate Tax Comm'n, —— U.S. ——, 98 S.Ct. 799 (1978); Kinnear v. Hertz Corp., 545 P.2d 1186 (Wash. 1976).

The MTC auditor made several significant adjustments in the computation of ASARCO's Idaho tax returns for the years of 1968, 1969 and 1970. These adjustments, which were accepted by the Idaho State Tax Commission, resulted in the tax deficiencies at issue in this case. These adjustments may be summarized as follows.

The MTC auditor combined or "unitized" with ASARCO, pursuant to I.C. § 63-3027(s), six corporations—all wholly owned subsidiaries of ASARCO.[1] Because these corporations were unitized with ASARCO, their incomes were combined with ASARCO's for Idaho tax purposes. However, dividends paid by the six corporations to ASARCO were not considered as income to ASARCO but were viewed by the auditor as intracompany transfers.

The MTC auditor also made significant changes in the computation of ASARCO's "business income," which was subject to apportionment. I.C. § 63-3027(i). These changes are best summarized in terms of the type of income involved.

---

[1] The "unitized" corporations were: Federal Metals of Canada; ASARCO Mercantile Co.; Enthone, Inc.; International Metal Co.; Lone Star Lead Construction Co.; and Northern Peru Mining Co.

Dividend Income: From a monetary standpoint, this is the most significant of the disputed items of income. The MTC auditor included as business income dividends paid ASARCO by various corporations, other than the six "unitized" corporations. The dividends from these "non-unitized" corporations totaled $48,310,126.00 in 1968, $66,374,-428.00 in 1969, and $61,772,970.00 in 1970. This dividend income represented a substantial portion of ASARCO's total income for the tax years in question. Summarized below are the activities of the principal corporations which paid ASARCO these dividends and their relationship to ASARCO.

1. Southern Peru Copper Corporation: This corporation produces blister copper, a material which is 99% copper and also contains byproduct material such as gold, silver and florium. ASARCO owns 51.5% of the stock and the remainder is owned by three other mining companies. Pursuant to a management agreement, ASARCO is entitled to elect a plurality but not a majority of the directors. Southern Peru has its own staff, but ASARCO provides certain technical assistance such as purchasing, traffic and tax preparation services. ASARCO receives a negotiated fee for these services.

Approximately 30% of Southern Peru's blister copper is sold to European customers through Southern Peru Copper Sales Corporation. The stock ownership in this sales corporation is the same as in Southern Peru. However, it is staffed entirely by ASARCO employees. The European sales are made through the sales corporation in order to preserve Southern Peru's favored federal tax status as a Western Hemisphere Trading Corporation. The remainder of Southern Peru's blister copper is divided among the four stockholders according to their ownership, *e.g.*, ASARCO receives 51.5% of the remainder. The price for the copper is determined by reference to a quotation in a trade publication, and during the years in

question ASARCO's purchases from Southern Peru were substantial. This output contract with Southern Peru is important to ASARCO but is not essential to its smelting business.

2. M.I.M. Holdings, Ltd.: This is a major corporation engaged in the mining, milling, smelting and refining of copper, lead, zinc and silver in Australia and which also operates a lead and zinc refinery in England. Hence, it is involved in virtually the same business as ASARCO. ASARCO owns 52.7% of the stock, and the rest is widely held. However, ASARCO has no directors or officers in M.I.M. At trial an ASARCO executive explained its failure to elect any directors as follows:

> "This company has been very successful in staffing the corporation with Australian people and [they have] been able to run this company by themselves and, therefore, in consequence of the nationalistic feeling which develops in most of such developing countries we have not exercised any right we might have to elect a director to the board of the company."

M.I.M. uses an ASARCO furnace patent, for which it pays a royalty, and occasionally ASARCO provides it some technical services. It is not economically feasible to ship ore or concentrates from Australia to the United States for smelting and there is only an insignificant amount of sales between these two corporations. In general, M.I.M. operates independently of ASARCO.

3. General Cable and Revere Copper: These two copper fabricators are major customers of ASARCO and ASARCO owned approximately 34% of the stock in each corporation. The remaining stock was widely held. Revere Copper also uses an ASARCO patent, for which it pays royalties, and both companies utilize ASARCO's stock transfer department, for which they pay a fee. In 1961 the United States Department of Justice filed an antitrust

action against ASARCO because of its interest in General Cable and Revere Copper. The action resulted in consent decrees signed in 1967 which prohibited ASARCO from maintaining common officers in these companies, voting its stock, selling these companies copper at prices lower than those quoted their competitors, and acquiring stock in any other copper fabricator. In 1970 ASARCO was compelled to divest itself of its stock in General Cable. Following the divestiture, General Cable continued to be a major customer of ASARCO.

4. Lake Asbestos of Quebec, Ltd.: This company mines and processes asbestos fibers in Canada. Its products are sold throughout the world, and in order to preserve its status as a Western Hemisphere Trading Corporation its sales are made through a conduit corporation, ASARCO International Corporation. Both Lake Asbestos and ASARCO Intl. are wholly owned by ASARCO. Lake Asbestos has its own staff, but ASARCO provides important management services. Lake Asbestos seeks ASARCO's direction and approval on major policy decisions. ASARCO Intl. is staffed entirely by ASARCO and Lake Asbestos employees. The business activities and operations of Lake Asbestos and ASARCO Intl. are in a field unrelated to ASARCO's mining and smelting operations and involve different technology. ASARCO shared no facilities, customers or sales force with these companies and it did not purchase any of their products.

5. ASARCO Mexicana, S.A.: This company mines and smelts lead and copper in Mexico. ASARCO owns 49% of the stock and the remainder is publicly held by Mexican nationals. At one time ASARCO owned 100% of the company, but in 1965 was required by Mexican law to divest itself of 51% of the stock. ASARCO Mexicana does not seek approval from ASARCO concerning major policy decisions, but ASARCO does provide technical services, makes some direct purchases from ASARCO Mexicana, and

acts as its agent for sales outside Mexico. ASARCO Mexicana pays ASARCO for those services.

6. Compania American Smelting, S.A.: This is a small company which purchases ore in Chile for ASARCO smelters. It is wholly owned by ASARCO and paid ASARCO small dividends in 1968 and 1969.

7. Hecla Mining Co., Kennecott Copper Co., Phelps-Dodge and United Park City Mines: These are four mining companies in which ASARCO owns a very small percentage of the stock. ASARCO exercises no control over these corporations and they made only minimal sales to ASARCO.

Interest Income: ASARCO received interest income from a variety of sources, including customers' notes and bonds, notes taken in connection with the sale of an Illinois plant and the sale of General Cable stock, and time certificates, bankers' acceptances and commercial paper notes. In its brief ASARCO indicates that it originally reported only its interest income from trade accounts receivable as business income. The MTC auditor, however, classified all of the foregoing interest income as business income.

Rents: ASARCO's rental income, which the auditor considered business income, was for the most part derived from homesites rented to employees working near ASARCO mines and plants.

Royalties: ASARCO earned royalties from leases to third parties of a portion of its mineral land, and from licenses to third parties of patents developed by ASARCO and used in ASARCO's business. The MTC auditor considered these royalties as business income.

Capital gains and losses: ASARCO realized gains on the disposition of three categories of assets: fixed assets, notes and bonds, and securities. The fixed assets were used in ASARCO's everyday business activities. The notes and bonds consisted of United States Treasury notes and bonds

and state and municipal notes and bonds. They were primarily acquired with idle cash in order to earn a return while the funds were not needed in ASARCO's business operations and they were generally held less than a year. The securities were in ASARCO subsidiaries and General Cable. The gains and losses realized from the disposition of these assets were all considered as business income by the MTC auditor.

The MTC auditor also made an alteration in the computation of the three factor formula used to apportion ASARCO's business income. UDITPA provides for the computation of a ratio of the taxpayer's property, payroll and sales in Idaho to its property, payroll and sales everywhere. This ratio, the Idaho apportionment factor, is applied to the taxpayer's total business income and the result is the portion of the taxpayer's business income attributable to Idaho and subject to its income tax. I.C. § 63-3027(i)-(q). In computing the denominator—the everywhere portion—of the sales factor, ASARCO included the value of some ore transferred from its mines in Idaho to its smelter in Montana. However, ASARCO did not include those transfers in the numerator of the sales factor in either Idaho or Montana, which is also a member of the multistate compact and participated in the joint audit. The MTC auditor included those transfers in the numerator of the Idaho sales factor but not in the numerator of the Montana sales factor.

As a result of all the adjustments by the MTC auditor, which were adopted by the commission, the commission assessed against ASARCO Idaho income tax deficiencies of $92,471.88 for 1968, $111,292.44 for 1969, and $121,750.76 for 1970, plus interest. ASARCO sought review of the deficiencies in the district court pursuant to I.C. § 63-3049. Following a court trial, the district court upheld the combination of ASARCO with six of its subsidiaries for tax reporting purposes, but the court determined that the

commission had erred in including the dividends, interest, royalties, rents and capital gains as business income. The district court did not modify the numerator of the sales factor to include the intracompany ore transfers as requested by the commission. The commission has appealed from the district court's ruling concerning the classification of income and from the court's refusal to modify the sales factor. ASARCO has not cross appealed from the district court ruling that the six subsidiaries were properly combined with ASARCO. This appeal therefore raises two sets of issues: (1) the classification of the disputed income, and (2) the modification in the sales factor. We address them in that order.

II

CLASSIFICATION OF INCOME

ASARCO challenged the commission's apportionment of its income from dividends, interest, rentals, capital gains and royalties as being inconsistent with a proper interpretation of the definition of business income found in I.C. § 63-3027(a)(1) and as being in violation of the due process and commerce clauses of the United States Constitution. We consider first the issue of statutory construction and second the constitutional issues.

A

Interpretation of Statutory Provisions

Business income is defined as:

> "63-3027. COMPUTING TAXABLE INCOME OF CORPORATIONS.— . . . .
>
> "(a) As used in this section, unless the context otherwise requires:
>
> "(1) 'Business income' means income arising from transactions and activity in the regular course of the

taxpayers' trade or business and includes income from the acquisition, management, or disposition of tangible and intangible property when such acquisition, management, or disposition constitute integral *or necessary* parts of the taxpayers' trade or business operations. *Gains or losses and dividend and interest income from stock and securities of any foreign or domestic corporation shall be presumed to be income from intangible property, the acquisition, management or disposition of which constitute an integral part of the taxpayers' trade or business; such presumption may only be overcome by clear and convincing evidence to the contrary. . . .*" (Emphasis indicates provisions not part of the uniform act but added by the Idaho legislature.)[2]

A few general comments concerning this definition of business income are necessary in order to put the issues raised in this appeal in the proper perspective.

First, the income referred to in subsection (a)(1) is income arising from the taxpayer's trade or business which is conducted, in part at least, in this state. Some corporations, particularly large conglomerates, may be engaged in several separate and distinct trades or businesses. The state may include as business income only the taxpayer's income arising from a trade or business conducted in this state and is not entitled to apportion income arising from a trade or business having no connection with this state.

[2] In 1969 the legislature amended I.C. § 63-3027(a)(1) by deleting a phrase which limited the application of the presumption stated in the second sentence of the subsection to corporations "in which the taxpayer owns or has a right to acquire, directly or indirectly, more than five per cent (5%) of the voting stock . . . ." Ch. 319, § 9, 1969 Idaho Sess. Laws 982, 991-92. Neither party has argued that the prior statute requires a different result in this case than the application of the current statute, and the effect of that amendatory legislation is not an issue in this case.

However, "whether a number of business operations having common ownership constitute a single or unitary business or several separate businesses for tax purposes depends upon whether they are of mutual benefit to one another and on whether each operation is dependent on or contributory to others." Great Lakes Pipe Line Co. v. Commissioner of Taxation, 138 N.W.2d 612, 616 (Minn. 1965), *appeal dismissed* 384 U.S. 718 (1966). *See* Sperry & Hutchinson Co. v. Department of Revenue, 527 P.2d 729 (Ore. 1974); Idaho State Tax Comm. Reg. 27.IV.1.(b).[3] This qualification, though not directly stated by the statute's literal language, is required by the theory underlying apportionment statutes, *i.e.*, that the business income of a unitary business operating in several states cannot be precisely identified with particular states, *see generally*, Butler Bros. v. McColgan, 315 U.S. 501, 62 S.Ct. 701 (1942); Keesling & Warren, The Unitary Concept in the Allocation of Income, 12 Hastings L.J. 42 (1960), and by the constitutional requirement that there must be some minimal connection between the interstate business activities generating the income and the state seeking to tax that income. *See* Moorman Mfg. Co. v. Bair, —— U.S. ——, 98 S.Ct. 2340 (1978); Champion International Corp. v. Bureau of Revenue, 540 P.2d 1300, 1307-08 (N.M.Ct.App. 1975) (Lopez, J., specially concurring).

Second, under I.C. § 63-3027(a)(1) business income includes not only a corporation's typical earnings from its business activities but also income from tangible and intangible property if that property and income has the requisite connection with the corporation's trade or business. Prior to UDITPA most states did not apportion a multistate corporation's income from dividends, interest,

[3] Subsequent to the years involved in this appeal, the Idaho State Tax Commission adopted the interpretive regulations promulgated in 1973 by the Multistate Tax Commission. The Idaho regulation cited corresponds to MTC regulation IV.1.(b).

royalties, rents and gains, but, with some exceptions, the states allocated that income to a single jurisdiction. *See* State Taxation of Interstate Commerce: Hearings Before the Subcomm. on State Taxation of Interstate Commerce of the Senate Comm. on Finance, 93rd Cong. 1st Sess. 246, 252-54 (1973) (prepared statement of James H. Peters, The Distinction Between Business Income and Non-Business Income). Indeed, a preliminary draft of the uniform act followed this general approach. *See* First Tent. Draft of Uniform Allocation and Apportionment of Income Act, §§ 4-9, *reprinted in* Brief for Amicus Curiae, United States Steel Corp., Exhibit A. However, the Act in its final form and as enacted in this state specifically includes income from "the acquisition, management, or disposition of tangible and intangible property when such acquisition, management, or disposition constitute integral or necessary parts of the taxpayer's trade or business operations" as business income. I.C. § 63-3027(a)(1). This break with prior practice is underscored by the Idaho version of the Act which contains the specific presumption that income "from stock and securities of any foreign or domestic corporation" is business income and which may be overcome only by "clear and convincing evidence." I.C. § 63-3027(a)(1). In short, classifying income as interest, rents, royalties, dividends and capital gains does not determine whether the income is apportionable under UDITPA. All forms of income are subject to apportionment under UDITPA if the income falls within the definition of business income.

Third, we do not understand the statutory requirement that the acquisition, management, or disposition of the underlying property be an "integral or necessary" part of the taxpayer's trade or business, I.C. § 63-3027(a)(1), to mean that the property must be an absolutely indispensable part of the taxpayer's business. In taxation statutes the word "necessary" is not generally given such a restrictive meaning. *See, e.g.*, Welch v. Helvering, 290 U.S.

111, 54 S.Ct. 8 (1933) (expense deduction); Palo Alto Town & Country Village, Inc. v. Commissioner, 565 F.2d 1388 (9th Cir. 1977) (expense deduction); Boy's Club of Clifton, Inc. v. Township of Jefferson, 371 A.2d 22 (N.J. 1977) (exemption from property tax). Also, the word "necessary" was added to the uniform act by the Idaho legislature at the same time it added the presumption that income from stock and securities is business income. *See* ch. 254, § 1, 1965 Idaho Sess. Laws 639, 642-47. A very restrictive interpretation of "integral or necessary" would be inconsistent with the apparent legislative belief that income from securities would generally be business income. In our view the phrase "integral or necessary parts of the taxpayers' trade or business operations" refers to property which, though not absolutely essential to the conduct of the taxpayer's business, contributes to and is identifiable with the taxpayer's trade or business operations. *Cf.* Superior Oil Co. v. Franchise Tax Board, 386 P.2d 33, 38 (Cal. 1963) (defining "essential" as used in test for unitary business).

Although we do not read the phrase "integral or necessary" restrictively, our interpretation of that phrase is not as broad as that argued by the commission in this case. In a sense all investments and investment income of a corporation may benefit a corporation's business operations in that the investments may supply additional revenue for operating the trade or business, may improve the corporation's standing and financial posture, and in general may permit the corporation to conduct its regular business activities in a way it could not absent those investments. In this broad sense all corporate investments could be thought of as property the acquisition, management or disposition of which constitutes an integral or necessary part of its trade or business operations. This is the position argued by the commission. However, such an approach would include virtually all income as business income and would in effect emasculate the provisions of UDITPA which provide

for the allocation of income from specified tangible and intangible property. *See* I.C. § 63-3027(d)-(h). Under such a test it is doubtful whether a corporation could receive income that would not be classified as business income. Although the legislature clearly intended that the income from tangible and intangible property be included as business income in proper circumstances, it likewise intended that there would continue to be such a thing as corporate non-business investment income. Just as we reject the notion that income from tangible or intangible property is to be automatically classified as non-business income, we reject the notion that such income is to be automatically considered business income simply because the taxpayer's business operations may receive some incidental benefits from those investments.[4] *But see* Montana Department of Revenue v. American Smelting & Refining Co., 567 P.2d 901, 907-08 (Mont. 1977), *appeal dismissed* —— U.S. —— (1978).

In our view, in order for such income to be properly classified as business income there must be a more direct relationship between the underlying asset and the taxpayer's trade or business. The incidental benefits from investments in general, such as enhanced credit standing and additional revenue, are not, in and of themselves, sufficient to bring the investment within the class of property the

[4] The extent to which income from intangibles is to be apportioned as business income has been a source of controversy within the MTC itself. In 1971 the MTC promulgated interpretive regulations containing a very expansive definition of business income in this respect. *See* 32 CCH State Tax Rev. No. 40 at 3-4 (Oct. 5, 1971). However, in 1973 the MTC promulgated a new set of regulations which retreated somewhat from the expansive interpretation contained in the 1971 version. *See* 34 CCH State Tax Rev. No. 10 at 2-6 (Mar. 6, 1973); *see discussion* Boren, Specific Allocation of Corporate Income in California: Some Problems in the Uniform Division of Income for Tax Purposes, 30 Tax L.Rev. 607, 681-700 (1975).

acquisition, management or disposition of which constitutes an integral part of the taxpayer's business operations. This view furthers the statutory policy of distinguishing that income which is truly derived from passive investments from income incidental to and connected with the taxpayer's business operations.

Finally, the facts in this case are based substantially on a lengthy stipulation between the parties, and for the most part they are not disputed. The decisive issues concern the proper application of the Idaho version of UDITPA to these facts. Accordingly, the scope of our review, which is a review of questions of law, is substantially broader than in cases where we are reviewing issues which turn on the resolution of disputed facts. Montana Department of Revenue v. American Smelting & Refining Co., *supra*. *See* Wessells v. State, 562 P.2d 1042 (Alaska 1977); Walt Keeler Co. v. Atchison, Topeka & Santa Fe Ry. Co., 354 P.2d 368 (Kans. 1960); Wendling v. Cundall, 568 P.2d 888 (Wyo. 1977); *cf.* Clements v. Clements, 91 Idaho 732, 430 P.2d 98 (1967) (absence of findings disregarded where facts clear from record). Also, most of the disputed items of income are "[g]ains or losses and dividend and interest income from stock and securities of . . . foreign or domestic corporation[s]." I.C. § 63-3027(a)(1). Such items of income are presumed to be "from intangible property, the acquisition, management, or disposition of which constitutes an integral part of the taxpayer's trade or business;" and this presumption may be overcome only by "clear and convincing evidence to the contrary." *Id.* Thus we must review the evidence to determine whether the trial court's findings contrary to that presumption are supported by clear and convincing evidence. *See* Ed Sparks & Sons v. Joe Campbell Constr. Co., 99 Idaho 139, 578 P.2d 681 (1978).

With these principles in mind we turn now to the issues concerning the application of the business income defini-

tion to the items of income involved in this appeal. We discuss these issues in terms of the type of income involved.

Dividends: With respect to the dividends involved here, the critical question is whether this income arose from ASARCO's business activities and whether ASARCO's acquisition, management or disposition of the underlying stock constitutes an integral or necessary part of its mining, smelting and refining business.

The district court ruled that the commission erred in classifying the dividends as business income, stating:

> "The next question is whether the dividends, interest, patent royalties and capital gains, together with rental income, were subject to tax by the State of Idaho as business income. The court has reviewed the facts and the authorities submitted by the parties and has concluded that they are not. American Smelting and Refining Company is in the business substantially of mining, smelting and refining and sales. The income described does not come from property or activities which is an integral part of taxpayer's trade or business. Plaintiff's position is well taken in that it would be unreasonable, unfair and contrary to the law to allow the State of Idaho to throw this income in to be taxed under the circumstances of this case without allowing the plaintiff to consider all of the income and all of the expenses of all of the corporations involved. It appears to the court that if the dividend income from other corporations is an integral part of the business of the plaintiff that they should be unitized and all matters considered and if they are not that the income is not business income but is non business income."

The district court appears to have disapproved of the commission's action in including the dividends as business income for two reasons. First, the district court stated that

it was an error to include this income "without allowing [ASARCO] to consider all the income and all the expenses of all the corporations involved." Presumably the trial court was referring to the fact that the sales, payroll and property of the dividend-paying corporations were not represented in the three factor apportionment formula. We note, however, that although the statute clearly provides for the apportionment of dividend income when such income falls within the statutory definition of business income, it does not specifically provide for the representation of the sales, payroll and property of the dividend-paying corporations in the apportionment formula. *See* I.C. § 63-3027(j)-(r). The commission's apportionment of the dividends without including the factors of these corporations in the formula did not violate the statutory provisions. However, the commission's action does raise certain constitutional questions which we consider later in this opinion.

Second, the district court seems to have concluded that since the corporations which paid the dividends were not sufficiently connected with ASARCO's business operations to justify combining those corporations with ASARCO for tax reporting purposes pursuant to I.C. § 63-3027(s), the stock ASARCO owned in those corporations was *ipso facto* not an integral or necessary part of ASARCO's trade or business so as to justify including the dividends they paid ASARCO as part of ASARCO's apportionable business income under I.C. § 63-3027(a)(1). When corporations are combined under subsection (s) for tax reporting purposes, the dividends paid one corporation by the other are not considered income but, as the commission did in this case, are properly treated as intracompany transfers. The district court's reasoning, therefore, would preclude dividends from ever being classified as business income and is thus clearly inconsistent with subsection (a)(1) which presumes that dividends are business income. The effect of this reasoning would nullify the statutory provision, a result

we must avoid if possible. Magnuson v. Idaho State Tax Commission, 97 Idaho 917, 556 P.2d 1197 (1976).

However, these provisions are not necessarily inconsistent. They have different objectives and they can be read harmoniously if those objectives are kept in mind. The combined reporting provision of subsection (s) is a further refinement of the basic apportionment principle. Its purpose is to permit application of the UDITPA formula to a single business enterprise which is conducted by means of separately incorporated entities. *See* United States Steel Corp. v. Multistate Tax Commission, —— U.S. ——, ——, n. 25, 98 S.Ct. 799, 813, n. 25 (1978). In an economic sense such a business is no different than a similar business composed of a single corporation with several separate divisions. *Compare* Butler Bros. v. McColgan, *supra, with* Edison California Stores, Inc. v. McColgan, 183 P.2d 16 (Cal. 1947). For tax reporting purposes such businesses should be treated the same. Coca Cola Co. v. Department of Revenue, 533 P.2d 788 (Ore. 1975); Keesling, A Current Look at the Combined Report and Uniform Allocation Practices, 42 J.Tax. 106 (1975).

In contrast, subsection (a)(1), which authorizes the apportionment of a taxpayer's dividend income in certain circumstances, addresses a very different question. While the combined reporting provision concerns a proper identification of the contours of the business enterprise, the business income definition of subsection (a)(1) concerns the differentiation between truly passive investment income and income which is incidental to or connected with the taxpayer's business operations. These are two related but conceptually and legally very different questions. Simply because the management, operation and activity of a corporation in which the taxpayer owns stock is not so closely connected with the management, operation and activities of the taxpayer to warrant a combined tax return, does not *ipso facto* mean that the dividends the taxpayer receives from that stock cannot be "income arising from transactions and activities in the regular course of the taxpayer's trade or business" and that the "acquisition, management, or disposition" of the stock does not "constitute integral or necessary parts of the taxpayer's trade or business operations." I.C. § 63-3027(a)(1). The combined reporting provision and the business income definition serve different purposes, ask different questions and apply different standards. The answer to one does not necessarily imply the same answer to the other.

With respect to the dividends ASARCO received from Southern Peru Copper Corp.; M.I.M. Holdings, Ltd.; General Cable; Revere Copper; ASARCO Mexicana, S.A.; and Compania American Smelting, S.A., we conclude that the record does not contain clear and convincing evidence to rebut the statutory presumption and does not support the trial court's finding that those dividends were not business income. For the years in question ASARCO owned a controlling or at least a very substantial interest in each of these corporations. They are all engaged in businesses closely related to ASARCO's mining and smelting operations and, with the exception of M.I.M., ASARCO did a substantial amount of business with them and provided them with a variety of technical services. The clear inference from these facts is that ASARCO's interest in these companies was not merely that of a passive investor but that this dividend income arises from ASARCO's mining and smelting business and that ASARCO acquired and maintained its ownership interest in these companies as an integral and necessary part of its mining and smelting business. We recognize that M.I.M., for the years in question, seems to have operated independently of ASARCO and did little if any business with ASARCO. Although ASARCO owns a controlling interest in M.I.M., ASARCO did not exercise its right to control the corporation, apparently for political reasons. Nevertheless, ASARCO does own a majority of M.I.M. stock and M.I.M. is engaged in

virtually the same business as ASARCO. Given these facts and the statutory presumption we conclude that the trial court erred in concluding that ASARCO's interest in M.I.M. was merely a passive investment unrelated to ASARCO's mining and smelting business.

However, we conclude that there was clear and convincing evidence to sustain the trial court's finding that the dividends from Lake Asbestos, ASARCO Int., Hecla Mining Co., Kennecott Copper Co., Phelps-Dodge and United Park City Mines were not business income. Although the record indicates certain management connections between ASARCO and Lake Asbestos and ASARCO Intl., the record indicates that this asbestos mining and processing activity is distinct, separate and unrelated to ASARCO's general mining and smelting business. Regardless of whether the dividends these corporations paid ASARCO would have constituted business income with respect to an asbestos business, the record discloses that these asbestos operations have no connection with the trade or business ASARCO conducts. Therefore, that dividend income is not business income subject to apportionment by this state. *See* Sperry & Hutchinson Co. v. Department of Revenue, *supra.*

The four remaining companies from which ASARCO received dividends are all engaged in mining activities similar to those pursued by ASARCO. Nevertheless, ASARCO's stock ownership in those companies is so small and its business dealings with them are so insignificant that, despite the statutory presumption, we conclude that the trial court's finding that ASARCO's ownership of that stock was more of a separate investment activity than a part of its trade or business operations is supported by the evidence. Therefore, the dividends these companies paid ASARCO should not have been included as business income.

Interest:[6] In general, the source of ASARCO's interest income was customer notes and other obligations ASARCO received in the regular course of its mining and smelting operations. As such, they were therefore properly considered as business income by the commission, and the trial court's findings to the contrary are not supported by the evidence. *See* Montana Department of Revenue v. American Smelting & Refining Co., *supra;* Sperry & Hutchinson Co. v. Department of Revenue, *supra;* Champion International Corp. v. Bureau of Revenue, *supra; cf.* Great Lakes Pipe Line Co. v. Commissioner of Taxation, 138 N.W.2d 612 (Minn. 1965) (interpreting statute analogous to UDITPA), *appeal dismissed* 384 U.S. 718 (1966).

Rents: ASARCO's rental income was primarily derived from property used in or very closely related to its mining and smelting operations. Accordingly, the trial court erred in excluding rents from business income. I.C. § 63-3027(a)(1) and (d). *See* Montana Department of Revenue v. American Smelting & Refining Co., *supra;* Champion International Corp. v. Bureau of Revenue, *supra.*

Royalties: The record indicates that the assets generating ASARCO's royalty income were acquired or developed by ASARCO in the course of its regular business operations. This income was related to or a consequence of its business operations and was therefore properly considered business income by the commission. *See* Montana Department of Revenue v. American Smelting & Refining Co., *supra; cf.* Texaco, Inc. v. Wasson, 237 S.E.2d 75 (S.C. 1977) (interpreting statute analogous to UDITPA).

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[6] The presumption of business income in I.C. § 63-3027(a)(1) extends only to "gains and losses and dividends and interest income from stock or securities of any foreign or domestic corporation. . . ." It does not apply to gains and losses and interest income from other sources or to rents and royalties. With respect to income not encompassed by the statutory presumption, ASARCO, as the plaintiff, bore the usual burden of persuading by a preponderance of the evidence.

Capital gains and losses: As previously mentioned, ASARCO's capital gains and losses resulted from the disposition of three types of assets: fixed assets, short term notes and bonds, and securities.

The fixed assets were used in ASARCO's everyday business activities and therefore gains realized on their disposition were business income. The trial court's finding to the contrary is not supported by the evidence.

The notes and bonds represented the short term investment of idle funds until they were needed in ASARCO's ordinary business operations. Accordingly, the trial court erred in not considering the gains realized from the disposition of those notes and bonds as business income. *See* Montana Department of Revenue v. American Smelting & Refining Co., *supra;* Sperry & Hutchinson Co. v. Department of Revenue, *supra;* Champion International Corp. v. Bureau of Revenue, *supra; cf.* Great Lakes Pipe Line Co. v. Commissioner of Taxation, *supra.*

ASARCO also realized gains from the sale of stock in its subsidiaries and General Cable. In our view the same standard applies to the question whether gains from the sale of stock are business income as applies to the question whether dividends from the stock are business income. The focus of the inquiry should be upon the purpose and use of the stock by ASARCO prior to its disposition. *See* I.C. § 63-3027(a)(1); Montana Department of Revenue v. American Smelting & Refining Co., *supra*; Champion International Corp. v. Bureau of Revenue, *supra; cf.* Johns-Manville Products Corp. v. Commissioner of Revenue Administration, 343 A.2d 221 (N.H. 1975) (similar approach, but not interpreting UDITPA), *appeal dismissed* 423 U.S. 1069 (1976). Inasmuch as we have already concluded that the trial court's conclusion that ASARCO sustained its burden of proving by clear and convincing evidence that the dividends it received from this stock were not business income is not supported by the evidence, we similarly conclude that the trial court's conclusion that the gains and losses realized on the disposition of the stock were not business income is not supported by the record.

Having resolved these issues concerning the items of ASARCO's income which are properly apportionable under the Idaho version of UDITPA, we consider now the constitutional questions.

B

Constitutional Issues

The constitutionality of formulary apportionment is firmly established under both the due process and commerce clauses of the United States Constitution. Moorman Mfg. Co. v. Bair, —— U.S. ——, 98 S.Ct. 2340 (1978); General Motors Corp. v. District of Columbia, 380 U.S. 553, 85 S.Ct. 1156 (1965); Bass, Ratcliff & Gratton, Ltd. v. State Tax Comm., 266 U.S. 271, 45 S.Ct. 82 (1924). ASARCO does not attack the constitutionality of formulary apportionment in the abstract, but argues that the manner in which the commission applied the UDITPA formula in this case produced a result violative of the due process and commerce clauses. We consider first the issues raised under the due process clause and then those raised under the commerce clause.

The Supreme Court of the United States recently summarized the limitations imposed by the due process clause on the states' power to tax the income of interstate businesses:

> "The Due Process Clause places two restrictions on a State's power to tax income generated by the activities of an interstate business. First, no tax may be imposed unless there is some minimal connection between those activities and the taxing state. . . . Second, the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing

state.'" Moorman Mfg. Co. v. Bair, —— U.S. ——, ——, 98 S.Ct. 2340, 2344 (1978) (citations omitted).

In the context of the first due process restriction, ASARCO argues that the commission imposed a tax on income derived from sources and activities which have no connection with this state. In particular, ASARCO refers to the apportionment of dividends it received. ASARCO argues that these dividends are derived from the business activities of the dividend-paying corporations and that these corporations have no connection with Idaho. This argument, however, rests upon a misconception of what the state sought to tax. As the Vermont court recently ruled in In re Goodyear Tire & Rubber Co., 335 A.2d 310 (Vt. 1975):

> "Goodyear's constitutional argument rests on its allegations that its extra-territorial values are being taxed. This allegation, however, fails to distinguish the foreign dividend income that Goodyear receives from its subsidiaries from the profits those subsidiaires realize from their own business activities conducted without the borders of Vermont. The right to receive dividends is incident to the ownership of stock. La-Fountain & Woolson Co. v. Brown, 91 Vt. 340, 342, 101 A. 36 (1917). Profits, on the other hand, are the net proceeds obtained by deducting from the gross proceeds all forms of expense or outlay involved in, or incidental to, the business in question. Stratton v. Cartmell, 114 Vt. 191, 195, 42 A.2d 419 (1945).
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> . . . .
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> "The failure of the county court to make a finding on the issue of whether Goodyear's subsidiaries were operated as separate entities does not constitute error because of the lack of relevance such a finding has to the taxation of foreign dividend income. Vermont's corporate income tax does not seek to tax the profits

> realized from the business activities of Goodyear's subsidiaries conducted without the borders of Vermont. It is taxing only the dividend income realized by Goodyear itself." *Id.* at 311-12.

See F. W. Woolworth Co. v. Commissioner of Taxes, 328 A.2d 402 (Vt. 1974); Gulf Oil Corp. v. Morrison, 141 A.2d 671 (Vt. 1958). The commission did not levy a tax upon the income of the dividend-paying corporations; rather, it levied a tax upon ASARCO's income. Those dividends are clearly part of ASARCO's income and it is unquestioned that there is a sufficient connection between ASARCO and this state to constitutionally permit the state to tax its proper share of ASARCO's income. If the due process clause were to prohibit the inclusion of dividends in a taxpayer's taxable income unless the payor corporation also conducts business within the taxing state, the due process clause would logically also prohibit the taxpayer's domicile from taxing those dividends if the payor corporation did not conduct its business within the domiciliary state, and indeed it would prohibit the United States and any state from ever taxing dividends paid the taxpayer by a corporation whose activities are located entirely without this country. The due process clause simply does not limit the right to tax dividends paid a taxpayer to the jurisdictions in which the payor corporation conducts its business. We believe that any constitutional limitations upon a state's right to apportion the intangible income, including dividends, of a multistate corporation doing business within the state are satisfied by the Idaho statutory requirement that the acquisition, management or disposition of the underlying asset must be an integral or necessary part of the taxpayer's unitary business, a part of which is conducted in this state. *See* In re Goodyear Tire & Rubber Co., *supra;* F. W. Woolworth Co. v. Director of Division of Taxation, 213 A.2d 1 (N.J. 1965); Great Lakes Pipe Line Co. v. Commissioner of Taxation, 138 N.W.2d 612 (Minn. 1965), *appeal dis-*

missed 384 U.S. 718, (1966); Champion International Corp. v. Bureau of Revenue, 540 P.2d 1300 (N.M.App.Ct. 1975); *cf.* National Leather Co. v. Massachusetts, 277 U.S. 413, 48 S.Ct. 534 (1928) (franchise tax measured by capital stock); Cleveland-Cliffs Iron Co. v. Michigan Corporation & Securities Comm., 88 N.W.2d 564 (Mich. 1958) (franchise tax measured by capital stock). *But see* Square D Co. v. Kentucky Bd. of Tax Appeals, 415 S.W.2d 594 (Ky. 1967); Gulf Oil Corp. v. Clayton, 147 S.E.2d 522 (N.C. 1966).

In the context of the second due process limitation—that the income attributed to Idaho for tax purposes must be rationally related to values connected with this state—ASARCO attacks the commission's computation of its tax liability on two grounds. ASARCO first argues that if the dividends it received are included as apportionable business income, then the due process clause requires that the property, payroll and sales factors of the dividend paying corporations be included in the denominator of the apportionment formula; otherwise ASARCO claims the income apportioned to Idaho would be disproportionate to the income producing activities within the state. This argument is premised on the same misconception about the entity and income the state is attempting to tax that we discussed above and has been soundly rejected for the same reasons. F. W. Woolworth Co. v. Commissioner of Taxes, 328 A.2d 402 (Vt. 1974); *see also* F. W. Woolworth Co. v. Director of Division of Taxation, 213 A.2d 1 (N.J. 1965).

In any event, I.C. § 63-3027 does not provide for the inclusion of the factors of these corporations in the apportionment formula. From a constitutional standpoint, this argument presents the same question raised by ASARCO's second argument that, regardless of whether the apportionment formula was properly computed, in this case it produced a result violative of the due process clause. The United States Supreme Court recently summarized the burden ASARCO must sustain in order to prevail on this argument:

> ". . . But in neither *Hans Rees'* nor *Norfolk & Western* did the Court depart from the basic principles that the States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted . . . in that State.' 283 U.S., at 135, or has 'led to a grossly distorted result.' 390 U.S., at 326. Moorman Mfg. Co. v. Bair, —— U.S. ——, 98 S.Ct. 2340, 2345 (1978).

ASARCO's arguments in this respect are based upon a comparison of the income apportioned to Idaho by the formula with the income ASARCO claims was actually earned by its Idaho operations as evidenced by its own separate accounting analysis. For example, ASARCO's separate accounting analysis shows a loss of $1,464,885 from its Idaho operations in 1969. This loss was primarily from its exploration and development activities. Testimony indicated that some of its Idaho operations operated at a profit. However, the apportionment formula attributed $2,274,750, or 2.53% of ASARCO's business income in 1969, to Idaho.

In general, multistate businesses have been remarkably unsuccessful in attacking the results of apportionment formulas by comparing those results with those of a separate accounting analysis. *See, e.g.,* Butler Bros. v. McColgan, 315 U.S. 501, 62 S.Ct. 701 (1942); John Deere Plow Co. v. Franchise Tax Bd., 238 P.2d 569 (Cal.), *appeal dismissed* 343 U.S. 939 (1951); Walgreen Co. v. Commissioner of Taxation, 104 N.W.2d 714 (Minn. 1960); Crane Co. v. Carson, 234 S.W.2d 644 (Tenn.), *cert. denied* 340 U.S. 906 (1950). *But see* Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, 51 S.Ct. 385 (1931) (formula which taxed 80% of income while only 17% had actual source in state). The reason why such arguments generally fail is explained

in the United States Supreme Court's decision in *Butler Bros.*:

> "It is true that appellant's separate accounting system for its San Francisco branch attributed no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand. . . . A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. . . . That may be due to the fact, as stated by Mr. Justice Brandeis in Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 121, 41 S.Ct. 45, 47, 64 L.Ed. 165, that a State in attempting to place upon a business extending into several States 'its fair share of the burden of taxation' is 'faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.' Furthermore, the particular system used may not reveal the facts basic to the State's determination. . . . In either aspect of the matter the results of the accounting system employed by appellant do not impeach the validity or propriety of the formula which California has applied here." 315 U.S. at 507-08, 62 S.Ct. at 704 (citations omitted).

Accordingly, the constitutional question is not whether the result reached by the apportionment formula is grossly disproportionate to the result reached by ASARCO's separate accounting analysis, but the proper question is whether ASARCO has established by clear and cogent evidence that the income attributed to the state by the apportionment formula is in fact "out of all appropriate proportion" to ASARCO's business activities in the state. In our view ASARCO has not sustained that burden.

The essence of ASARCO's argument under the commerce clause is that since Idaho's use of the UDITPA apportionment formula may result in the duplicative taxation of its income by other states, the statute places an unconstitutional burden on interstate businesses. In particular, ASARCO emphasizes that since many states allocate income from intangible and tangible property to a single jurisdiction, the apportionment by Idaho of the same income will result in multiple taxation. However, ASARCO has not established that it was in fact subject to multiple taxation and the possibility of such double taxation has been rejected as a ground for invalidating an apportionment statute. Moorman Mfg. Co. v. Bair, *supra*. Moreover, the courts have consistently held that the possibility of overlapping taxation does not present constitutional problems so long as the state's formula, considered on its own merits, is not repugnant to the Constitution. *See* Moorman Mfg. Co. v. Bair, *supra;* General Motors Corp. v. State, 509 P.2d 1260 (Colo. 1973); Hellerstein, Symposium Foreword, State Taxation Under the Commerce Clause: An Historical Perspective, 29 Vand.L.Rev. 335, 347 (1976). As the Court in *Moorman* stated:

> "This method [formula apportionment], unlike separate accounting, does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State. The single-factor formula used by Iowa, therefore, generally will not produce a figure that represents the actual profits earned within the State. But the same is true of the Illinois three-factor formula. Both will occasionally over-reflect or under-reflect income attributable to the taxing State. Yet despite this imprecision, the Court

has refused to impose strict constitutional restraints on a State's selection of a particular formula. ——U.S. at ——, 98 S.Ct. at 2344.

We find no constitutional infirmity under the commerce clause in the statute before us in this case. The problem raised by ASARCO is essentially the result of the lack of uniformity between the states. It would indeed be ironic for us to strike down this statute, which is patterned after a widely adopted uniform act drafted in an attempt to provide some uniformity in this area, on the grounds that it may be in conflict with the statutes of some other states which have not adopted the uniform act.

III

SALES FACTOR

In computing the sales factor for the tax years in question the commission included in the numerator, which represents the sales attributable to Idaho, intracompany transfers of ore from ASARCO's mines in Idaho to its smelter in Montana. The trial court excluded those transfers from the Idaho sales factor. ASARCO contends that the transfer should not be included in the numerator of the Idaho sales factor since the statute requires the sales to be reported on a destination basis and Idaho was not the final destination of these sales. I.C. § 63-3027(p)(1). The commission, however, argues that ASARCO's accounting method made it extremely difficult, if not impossible, to determine the sales on a final destination basis and that its adjustment of the sales factor was a proper exercise of its authority under I.C. § 63-3027(r) to make adjustments in the formula when "the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state . . . ."

Although the record is somewhat confusing in this respect, the controversy appears to center on ASARCO's "margin method" of accounting, which ascribes the receipts

from the sale of primary metals to the various steps within its mining, smelting and refining operations. According to the auditor's testimony at trial, if ASARCO, for example, received $6.00 on the final sales of a primary metal, its margin method of accounting would attribute, for example, $3.00 to its mining operation, $1.50 to its smelting operation, $1.00 to its refining operation, and the balance of $.50 to sales or sales commission.

The auditor appears to have encountered two problems in computing the sales factor with records maintained on this basis. First, I.C. § 63-3027(a)(5) and (o) require that the sales factor be computed on a gross receipts basis. The auditor testified that the total sales computed under this margin method of accounting would be the same as when computed on a gross receipts basis only if the ore was first extracted from ASARCO's mines. Where the ore was purchased from other mines, the auditor concluded that ASARCO's accounting method would reflect only the total value of the services ASARCO performed in smelting, refining and selling the ore, which in our example would be $3.00, and not the total gross receipts ASARCO would receive on the final sale of the product, $6.00 in our example.

Second, in general UDITPA requires that sales be reported in the numerator only if the goods were shipped to a purchaser in the taxing state. *See* I.C. §§ 63-3027(p)(1) and -3027(p)(2). Although this margin method of accounting would presumably indicate the value of the services performed by ASARCO's various operations in the various states, the auditor concluded that the records ASARCO maintained using this accounting method did not allow him to ascertain the final destination of ASARCO's sales of primary metals.

Because of these difficulties in using ASARCO's accounting method, the MTC auditor adjusted the numerator of the Idaho sales factor to include the value of ore shipped

from ASARCO's mines in Idaho to its smelter in Montana. However, these transfers of ore were clearly not true sales but merely intracompany transfers. Nevertheless, the auditor apparently believed this adjustment was necessary because of his inability to compute the sales factor according to the statutory method and in order to make the computation of the numerator consistent with ASARCO's margin method of accounting and its computation of the denominator.

The trial court did not address the propriety of this adjustment. However, we believe that the apportionment formula should be computed according to the procedures set forth in the statute unless use of these procedures in a particular case is impossible or entirely impractical or unless it is clearly established that the result produced by the statutory formula does "not fairly represent the extent of the taxpayer's business activity in this state . . . ." I.C. § 63-3027(r). We therefore remand this issue to the district court for further proceedings to determine whether the sales factor can be computed according to the statutory method. If on remand the court concludes that it cannot or that it produces a result which manifestly does not represent the extent of ASARCO's activity in the state, the court is to determine whether the adjustment made by the commission was a reasonable exercise of its authority under I.C. § 63-3027(r).

The case is reversed and remanded for further proceedings and for recomputation of ASARCO's income tax liability in accordance with this opinion.

Reversed and remanded.

SHEPARD, CJ., MCFADDEN, DONALDSON and BISTLINE, JJ., concur.

IN THE DISTRICT COURT OF THE FOURTH JUDICIAL DISTRICT OF THE STATE OF IDAHO, IN AND FOR THE COUNTY OF ADA

Case No. 53182

AMERICAN SMELTING AND REFINING COMPANY, *Plaintiff*,

vs

IDAHO STATE TAX COMMISSION, *Defendant*.

MEMORANDUM

Plaintiff filed suit alleging that the Idaho State Tax Commission had improperly determined income tax deficiencies and interest against the plaintiff for the years 1968, 1969, and 1970 in that deficiencies and interest charges had been assessed against the plaintiff by reason of income which plaintiff derived from dividends, interest, patent royalties and capital gains subject to tax by the State of New York, the commercial domicile of the plaintiff.

This matter came on for hearing and was submitted to the court upon the stipulation of the parties and the evidence that had been presented. The parties have presented their briefs. The primary questions appear to be first whether the tax commission properly combined the plaintiff with six of its wholly own subsidiaries which constitute a unitary business enterprise.

The court has reviewed this matter and could spend considerable time discussing the matter which I don't think would be beneficial to either of the parties or the Supreme Court where this matter is obviously headed. The court has concluded that the plaintiff and the six subsidaries do constitute a unitary business enterprise and were properly so treated for tax purposes.

The next question is whether the dividends, interest, patent royalties and capital gains, together with rental

income, were subject to tax by the State of Idaho as business income. The court has reviewed the facts and the authorities submitted by the parties and has concluded that they are not. American Smelting and Refining Company is in the business substantially of mining, smelting and refining and sales. The income described does not come from property or activities which is an integral part of taxpayer's trade or business. Plaintiff's position is well taken in that it would be unreasonable, unfair and contrary to the law to allow the State of Idaho to throw this income in to be taxed under the circumstances of this case without allowing the plaintiff to consider all of the income and all of the expenses of all of the corporations involved. It appears to the court that if the dividend income from other corporations is an integral part of the business of the plaintiff that they should be unitized and all matters considered and if they are not that the income is not business income but is non business income.

Counsel for the plaintiff may prepare such Findings of Fact and Conclusions of Law and Order as is necessary in conformance with this opinion.

Dated this 13th day of November, 1975.

/s/ MARION J. CALLISTER
Marion J. Callister
District Judge

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Case No. 53182

AMERICAN SMELTING AND REFINING COMPANY, *Plaintiff*,

vs

IDAHO STATE TAX COMMISSION, *Defendant*.

FINDINGS AND CONCLUSIONS

The court being fully advised in the premises, after having presided at pre-trial hearings, heard presentations of evidence at trial and argument and reviewed various briefs of the parties does hereby make the following:

Findings of Fact

1. The court has jurisdiction of the matters involved in this controversy and of the parties.

2. The court adopts and incorporates as if set out herein the stipulations of fact entered into, agreed upon, executed and entered into the record by the parties and the facts recited in the pre-trial order agreed upon by the parties and signed by the court.

3. Deficiency assessments against the plaintiff for the year 1968 in the amount of $92,471.88; 1969 in the amount of $111,292.44; and 1970 in the amount of $121,750.76 are the subject matter of this litigation.

4. The plaintiff utilizes separate accounting for internal purposes, uses this method for determining and reporting its taxable income for federal tax purposes and this method accurately reflects the plaintiff's taxable income in the State of Idaho.

5. The State Tax Commission is apportioning all income of taxpayer as business income and through apportionment taxing a portion of all plaintiff's income.

6. Plaintiff uses a separate accounting method using a margin's system. Plaintiff's taxable income in Idaho determined by separate accounting and plaintiff's taxable income in Idaho determined by apportionment method applied by the State Tax Commission in asserting the deficiency for the separate years involved in this case is:

	Separate Accounting	Apportionment	Difference
1968	($290,304.00)	$1,541,198.00	$1,831,502.00
1969	($1,464,885.00)	$2,274,750.00	$3,373,835.00
1970	($2,292,929.00)	$2,162,346.00	$4,455,275.00

7. The plaintiff is in the business of mining of copper and non-ferrous metals, gold, silver, copper, lead, zinc and asbestos, and in smelting and refining and selling these metals and in the sale of secondary metals. For the years involved, the percentage of operating income realized by plaintiff from its separate business operations is set out below

	1968	1969	1970
Mining	66%	59%	76%
Smelting & Refining	33%	38%	22%
Secondary Metals	1%	3%	2%

Mining earnings from separate minerals mined are:

	1968	1969	1970
Copper	86%	88%	91%
Lead and Zinc	12%	11%	7%
Silver	2%	1%	2%

8. Plaintiff's fixed asset investment in the separate businesses reflect the following percentages:

Mining	61%
Smelting and Refining	35%
Secondary Metals	4%

9. Plaintiff's principal business in Idaho is the mining of silver; it also mines lead and zinc, operates an administrative office for its northwest mining division and sells secondary metals in Idaho.

10. The silver mine operated by plaintiff in Idaho is the only silver mine owned or operated by plaintiff.

11. The plaintiff sells no primary metals, the destination of which is Idaho. Plaintiff sells secondary metals the destination of which is Idaho and for the years involved the sales were:

1968	$ 70,000.00
1969	$ 70,000.00
1970	$108,000.00

12. Plaintiff's mining operations in the northwest are limited to lead and zinc mines and the silver mine which it operates in Idaho.

13. Plaintiff's northwest mining division experienced losses for the years involved in the following amounts:

1968	($ 660,423.00)
1969	($2,880,727.00)
1970	($3,161,775.00)

14. Plaintiff does not smelt or refine ore produced in its Idaho mines in Idaho. This ore is shipped to smelters operated by the plaintiff in East Helena, Montana; El Paso,

Texas; and Selby, California. For the years involved, ore was shipped in the following proportions:

	East Helena	El Paso	Selby
1968	8.6%	40.7%	50.7%
1969	0%	56.5%	43.5%
1970	18.1%	58.3%	23.6%

15. For the years involved plaintiff's before tax earnings, including income from intangibles, and dividends paid by plaintiff to its shareholders were:

	1968	1969	1970
Before tax earnings	$80.6 mil.	$101 mil.	$102.5 mil.
Dividends paid	$38.2 mil.	55.2 mil.	53.9 mil.
Dividends as a percentage of earnings	48%	55%	53%

16. Plaintiff has never been required to utilize its stock as security for borrowing of working capital, acquiring stock or securities in other companies or to support any bond issues.

17. The taxpayer has sufficient cash flow from mining to provide operating capital for all mining operations without reliance upon cash flow from smelting, refining, sale of secondary metals or income from intangibles.

18. Plaintiff is the major custom smelter in the United States, doing approximately 80% of that work in this country.

19. Asarco Mercantile and International Metal Company are shell companies fully owned by the plaintiff, staffed, directed and controlled by plaintiff and using facilities owned by it and are subject to internal auditing by plaintiff. This subsidiary and the plaintiff constitute a unitary business.

20. Lone Star Lead Construction Company is wholly owned by plaintiff, staffed by plaintiff's employees, occupies facilities owned by plaintiff, identifies itself with its parent in advertising and does not operate independently of the plaintiff. This subsidiary and the plaintiff constitute a unitary business.

21. Enthone, Inc., is wholly owned by plaintiff, identifies itself with plaintiff in advertising, does not operate independently of the plaintiff and is subject to internal auditing by plaintiff. This subsidiary and the plaintiff constitute a unitary business.

22. Federated Metals is wholly owned and provided financing by plaintiff, does not operate independently of the plaintiff and is subject to internal auditing by plaintiff. This subsidiary and the plaintiff constitute a unitary business.

23. Northern Peru is wholly owned by plaintiff, does not operate independently of the plaintiff and is subject to internal auditing by plaintiff. This subsidiary and the plaintiff constitute a unitary business.

24. The combination of ownership and use through controlled operation is sufficient to require combination or unitization of these six companies with the plaintiff to accurately reflect income.

25. Asarco Australia, Asarco Development, Asarco Exploration, Compania American Smelting, S. A., Lake Asbestos of Quebec and Asarco International are wholly owned by plaintiff and are subject to control by plaintiff but are not integral or necessary parts of the plaintiff's business operations.

26. Neptune Gold Mining Company is 51.8% owned by plaintiff, is operated by plaintiff pursuant to contract but operates independently of plaintiff. Neptune Gold Mining Company is neither an integral part of plaintiff's business

nor necessary to plaintiff's business and prudent judgment does not dictate ownership of this stock.

27. Southern Peru Copper Sales is 51.5% owned by plaintiff, staffed by plaintiff's employees and is subject to control of plaintiff but is not an integral or necessary part of plaintiff's business operations which prudent business judgment dictates should be owned by plaintiff.

28. Asarco Mexicana is 49% owned by plaintiff, operates independently of plaintiff and is not an integral part of nor necessary to plaintiff's business and prudent business judgment does not dictate ownership of this stock.

29. Southern Peru Copper is 51.5% owned by plaintiff, subject to a management contract which insures that plaintiff will not be able to control said company, operates independently of plaintiff and is not an integral part of nor necessary to plaintiff's business nor does prudent business judgment dictate ownership of this stock.

30. M.I.M. Holdings is 52.7% owned by plaintiff, operates entirely independently of and has minimal contact with plaintiff, is not an integral or necessary part of plaintiff's business nor does prudent business judgment dictate ownership of this stock by plaintiff.

31. The court also finds that the other corporations in which plaintiff has stock interests are not controlled by plaintiff and are not integral parts of nor necessary to plaintiff's business and prudent business judgment does not dictate ownership of this stock by plaintiff.

32. Plaintiff has sustained its burden of proof and presented clear and convincing evidence that its income from intangibles is not business income.

33. The tax imposed pursuant to the method utilized by the State Tax Commission, apportioning dividends, interest, capital gains, rents and royalties as business income, and excluding from the property, sales and payroll factors

all or a proportionate part of the property, sales and payrolls of the corporations the dividends of which are apportioned arbitrarily assigns to Idaho income for tax purposes which does not reflect and greatly exceeds an amount which would accurately reflect plaintiff's business in Idaho.

Conclusions of Law

1. The court has jurisdiction of the subject matter and the parties.

2. Federated Metals of Canada, Asarco Mercantile, Inc., Enthone, Inc., International Metal Company, Lone Star Lead Construction Company and Northern Peru Mining Company are corporations wholly owned by plaintiff consolidation of which is necessary to accurately reflect plaintiff's income within the State of Idaho.

3. Asarco Australia, Asarco Development, Asarco Exploration, Compania American Smelting S.A., Lake Asbestos of Quebec, Asarco International, Southern Peru Copper, Southern Peru Copper Sales, M.I.M. Holdings, Neptune Gold Mining Company, Asarco Mexicana, General CAble, REvere Copper, Helca Mining, Kennicott Copper, Phelps Dodge, United Park City MInes [sic] and other companies in which plaintiff owns an interest are not integral to nor a necessary part of plaintiff's business operation nor does prudent business judgment dictate ownership of stock in these companies and plaintiff has met the burden of proof imposed upon it by statute in that the plaintiff has presented clear and convincing evidence that its income from intangibles is not business income.

4. The method used by the State Tax Commission in apportioning income is not authorized by the statute.

5. Plaintiff's income for 1968, 1969 and 1970 should be computed by apportioning business income but allocating

income from dividends, interest, royalties, rents and other non-business income to New York, its commercial domicile.

DATED this 14th day of November, 1975, as of this 15th day of January, 1976, nunc pro tunc.

/s/ MARION J. CALLISTER
Marion J. Callister
District Judge

The above findings and conclusions are accepted and ordered entered as a decision of the Ada County District Court.

/s/ ILLEGIBLE
District Judge

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

Docket No. C-340
C-501

In the Matter of the Petition for Redetermination of Income Tax Deficiency by

AMERICAN SMELTING & REFINING COMPANY (ASARCO)

DECISION

Taxpayer protests a Notice of Deficiency Determination proposing increases to its corporate income or franchise tax liability for calendar years 1968, 1969 and 1970. Initially, a Notice of Deficiency Determination was issued on September 14, 1971, for years 1968 and 1969. That determination was amended on March 27, 1973, when additional deficiencies were proposed for each of the initial two years, and a deficiency was also proposed for the calendar year 1970. (In addition, a deficiency for the calendar year 1967 was proposed, was not protested by the taxpayer, and is not in issue in this proceeding).

A protest dated April 12, 1973, was filed with the Commission April 18, 1973, objecting to the proposed deficiencies on the following grounds:

(a) The proposed deficiency incorrectly classified taxpayer and six of its subsidiary or affiliated corporations as a unitary enterprise pursuant to § 63-3027(s), *Idaho Code*. The six subsidiary or affiliated corporations are: (1) Federated Metals Canada Ltd. (2) ASARCO Mercantile Co. (3) Enthone, Inc. (4) International Metal Co. (5) Lone Star Lead Construction Corp. (6) Northern Peru Mining.

(b) The proposed deficiency incorrectly treated certain dividends (including dividends other than those received from the above six corporations), interest, patent royalties,

and capital gains as business income as such term is defined in § 63-3027, *Idaho Code.*

(c) Because the audit was in part conducted by the Multistate Tax Commission, and the Multistate Tax Compact is unconstitutional, the State Tax Commission may not, therefore, base an assessment upon the information obtained in the course of such audit.

In addition, the taxpayer, by a brief or "position" statement, attempted to add an additional objection to a portion of the proposed assessment imposing penalties on taxpayer. Such objection should have been raised by protest; however, it does not appear the staff has been prejudiced by the failure to include such objection in the protest and the protest or objection to the proposed assessment will be considered by the Commission.

The effect of the auditor's adjustment was to treat taxpayer and the six affiliated companies listed earlier in this Decision as a unitary business enterprise, combining such corporations into one entity or unit for accounting purposes, and to utilize the three factor formula provided by § 63-3027, *Idaho Code,* to determine what part of such unitary enterprise's income was properly attributable to Idaho. In addition, the auditor treated dividend income, interest, patent royalties, and capital gains received by members of the unitary enterprise as business income. Finally, the auditor imposed a penalty of 5 percent of the amount of the total deficiency based upon an erroneous reporting of part of a property factor during the year 1968.

The issue of the penalty imposed may be readily disposed of. During 1968 taxpayer had an inventory of ore. The inventory of ore was physically located within the state of Idaho and for Montana tax purposes was reported as being outside Montana, (and presumably within the state of Idaho). However, for Idaho tax purposes the inventory

was reported as not being within the state of Idaho, and such inventory was not included in data supposedly summarizing all Idaho property. There is no evidence indicating that a deliberate or willful misrepresentation to either state was intended; however, the error, while innocent, was not one that would be made by a reasonably prudent accountant in preparing the information needed. § 63-3046, *Idaho Code,* directs the assessment of a 5 percent penalty "if any part of any deficiency is due to negligence or disregard of rules and regulations" and Regulation 45 indicates that "any failure to file a tax return or to pay a tax lawfully due is presumed to be a result of negligence or disregard of the law, rules and regulations". In view of the statute, the penalty might seem to be "automatic"; however, practical experience the Commission has gained in administration of the tax laws of the state of Idaho indicates that each particular situation in which penalties have been assessed should be reviewed closely; we believe the proper objective is to both require full and honest disclosure from taxpayers by making it uneconomical to provide less than full and accurate disclosure, and at the same time not to unduly or unreasonably penalize taxpayers who have diligently attempted to comply with relevant statutes. In the present instance the Commission believes that the penalty should be imposed; however, the amount of the penalty should be restricted to the difference between the taxes due under taxpayer's initial reporting, and the taxes that should have been due if the information had been correctly reported. The effect of such a reduction is to make the penalty in this case commensurate with the magnitude of the error, and not to unduly penalize taxpayer because there were substantial other adjustments made at the same time as the adjustments warranting a penalty.

The remaining two issues are to some extent interrelated. In its protest, taxpayer objects to the treatment of ASARCO itself and the six corporations (hereafter referred to as the unitary subsidiaries) being combined for

accounting purposes. Such protest at some length objects to and points out why the taxpayer does not view such a unitary enterprise to be correct characterization. Later briefs, however, filed by the taxpayer do not treat this issue. In fact, if the Commission has correctly characterized dividends from the non-unitary enterprise corporations as business income, and if in fact the dividends from the unitary enterprise corporations would be business income to ASARCO itself, then the combination of the six unitary enterprise corporations with ASARCO to some extent decreases total tax liability to Idaho.

The doctrine of treating a series of inter-related corporations as a "unitary enterprise" is well established by judicial precedent. The doctrine originated in California, *Butler Bros. v. McColgan,* 315 U.S. 501, 62 S.Ct. 701, *Edison California Stores v. McColgan,* 183 P. 2nd 16 (Calif.) but today has been accepted in a number of jurisdictions. *Zale-Salem, Inc. v. State Tax Commission,* 237 Or. 261, 391 P. 2nd 601 (1964), *Interstate Finance Corp. v. Wisconsin Department of Taxation,* 28 Wis. 2nd 262, 137 N.W. 2nd 38 (1965). We believe § 63-3027(s), *Idaho Code,* was specifically intended to recognize the validity of the concept, which is grounded on the premise that corporations which do not in fact operate as independent business enterprises can only be effectively taxed as unitary business enterprises. In the present instance ASARCO itself characterizes its business in its protest (page 3) as ". . . the business of mining, smelting, refining, manufacturing, buying and selling non-ferrous metals, metalliferous and other mineral products."

While in years past there was some dispute over the point, for the years in question ASARCO itself has not contested the concept that it is engaged in only one business; it has not suggested that as a single company it engages in two or more businesses and it is quite clear from the evidence produced at the hearing that its business activ-

ities are so inter-related as to defy measurement by separate accounting, and to discredit the argument that its business in Idaho consisting of a silver-copper mine, and the exploration and development of ore bodies or mineral deposits, can be separated from ASARCO's worldwide activities.

The auditor suggested the following as indicating that the six unitary corporations are part of a unitary business enterprise consisting of themselves and ASARCO: (a) The wholly owned subsidiaries are engaged either in similar operations to ASARCO's or are conducting manufacturing or sales operations for ASARCO. (b) ASARCO and the unitary corporations have interlocking officers and directors which enables ASARCO to control the subsidiaries' activities and major management decisions. (c) Sales between ASARCO and the subsidiaries are numerous and services are provided between the subsidiaries and parent including management, accounting, budgeting, tax preparation, exploration, research, purchasing, sales and insurance procurement. (d) All of the subsidiaries are entirely owned by ASARCO. A brief description of the affiliated unitary corporations is helpful:

(a) *Federated Metals, Canada.* Effectively, this subsidiary may be characterized as ASARCO's method of doing business in Canada. In Canada it conducts the same business as the Federal Metals division of ASARCO carries on in the United States. The Federated Metals Division of ASARCO specializes in processing or re-processing used metals. It was originally created when ASARCO, during the 1930's, purchased the Federated Metals Company and converted it to a division of ASARCO. The division purchases scrap and also uses metals from its own primary plants when necessary; its main product is alloy metals or usable lead products such as lead rules and sheet lead. The Federated Metals Division of ASARCO does no business in Canada except to sell to Federated Metals, Canada;

Federated Metals, Canada, in turn does no business in the United States. ASARCO has provided capital to Federated Metals; the amount is not known, but interest on the loan from ASARCO to Federated Metals, Canada, varied between $140,000 to $200,000 per year.

(b) *ASARCO Mercantile.* ASARCO Mercantile business consists primarily of purchasing machinery and supplies for resale to other companies within the ASARCO group for resale. It was characterized by the witness for taxpayer as "a purchasing agent". It was set up to "isolate several of (the ASARCO subsidiaries) for Western Hemisphere trade corporation status". [See IRS (1954) Secs. 921 & 922] The prices at which such products would be bought and sold clearly can be effectively controlled by ASARCO management, and it seems to us that under any imaginable test, ASARCO Mercantile is properly categorized as "unitary" as it relates to ASARCO.

(c) *Enthone, Inc.* Enthone, Inc. produces metal finishing chemicals for sale to the metal finishing industry. It was acquired by ASARCO by purchase. Apparently its main business consists of sales of metal plating materials through relatively small commercial customers. Unlike other ASARCO affiliates, Enthone has its own sales force and has a more independent management (only the vice president of Enthone is also an officer of ASARCO). There are several members of the board of directors from ASARCO, however. Enthone purchases a part of its supplies and raw materials from ASARCO or other ASARCO affiliates; taxpayer's witness refused to characterize the purchases as "substantial" but did not know the nature of the purchases, which apparently are made from ASARCO's Federated Metals Division. Apparently, if needed supplies are available from ASARCO, they are purchased by Enthone from ASARCO.

(d) *International Metals Co.* International Metals Company business consists of purchasing metals from ASARCO

and resale of such metals overseas (generally in Europe). In fact, from the record made before the Tax Commission, if ASARCO Mercantile may fairly be characterized as a "purchasing agent" then International Metal Company may be fairly characterized as "a selling agent". Its sole function and existence seems to depend upon its activities in selling the ASARCO groups metal products overseas. Goods are sold by International Metal Co. from ASARCO's stock; its purchase from ASARCO and resale is a "paper" transaction and International Metal Co. serves as the conduit or selling agent for the ASARCO group's products. Finally, all of the officers of International Metal Co. are also officers or employees of ASARCO, and function interchangeably in their duties, one minute serving ASARCO, and the next International Metal Co.

(e) *Lone Star Lead Construction Corp.* Lone Star Lead is primarily in the business of installing or servicing lead lining in corrosive chemical tanks. Again, there apparently is common management and needed materials (including lead) are purchased from ASARCO.

(f) *Northern Peru Mining.* Northern Peru Mining conducts its primary business in Peru and it consists of operation of mines yielding lead, copper, zinc and silver. Northern Peru Mining is 100 percent owned by ASARCO; ore is treated in Peru in an initial treatment phase and reduced to a concentrate which contains approximately 25-30 percent copper. The ore during the period in question was then shipped to an ASARCO plant in California for further refining. The ore was processed at the California plant and sold through the ASARCO marketing system. During part of the time apparently all of the ore from the Northern Peru mine was sold to ASARCO; during the entire period most of the ore was sold to ASARCO. Sales to persons other than ASARCO occurred only because of a strike at the ASARCO California plant.

We believe the best statement of the definition or test for a unitary business enterprise was that formulated in *Butler Brothers vs. McColgan,* 111 P. 2d 334, and cited with approval in *Edison California Stores vs. McColgan,* 183 P. 2d 16:

> ". . . the unitary nature of appellant's business is definitely established by the presence of the following circumstances: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in its centralized executive force and general system of operation."

In the present instance we find each of the six corporations properly fall within the classification as an integral part of a unitary business enterprise, and they were properly combined by the auditor.

Finally, we must consider taxpayer's objection to the treatment of the following classes of income as business income:

1. Dividends
2. Interest
3. Patent Royalties
4. Gain from sales of capital assets

Very little was said during the hearing, or in briefs submitted by taxpayer or the staff, concerning items other than dividends. We believe that the management of investment and working capital is clearly an integral or regular part of this taxpayer's trade or business, and as the returns indicate, taxpayer received very substantial amounts of interest income (part of it coming from subsidiary corporations). While its direct interest income exceeded its direct income expense, we think on the record made before us that interest received by this taxpayer was received in

the regular course of its trade or business and arose from transactions and activities in the regular course of such trade or business.

The record is also unclear concerning the source and nature of taxpayer's patent royalty income.

We have already outlined the activities and business, and its relationship to that of ASARCO, carried on by the six unitary corporations combined with ASARCO. We would note that even if such companies were not combined with ASARCO, they are clearly inter-related with ASARCO, and dividends paid ASARCO by such companies would clearly be business income. We think it is helpful to outline the nature of the businesses conducted by the remaining corporations paying dividends to ASARCO.

(a) ASARCO Australia is a 100 percent owned subsidiary active in exploring minerals in Australia, and not operating within the United States.

(b) ASARCO Exploration Company is 100 percent owned and involved in mineral exploration activities, primarily outside the United States in Canada and other sections of the Western Hemisphere.

(c) ASARCO Developments is a 100 percent owned subsidiary involved in explorations in New Zealand.

(d) Compania American Smelting, S. A. is a 100 percent owned Chilian company whose activities are to buy ore in Chile. The purchases are made for ASARCO itself. Its character was described as that of a purchasing office for ASARCO; its profits are determined by the difference between the price it pays and the price at which it sells to ASARCO. That price in turn can be controlled by ASARCO, who owns the company and has the power to appoint officers and management.

(e) Lake Asbestos of Quebec, Ltd. is a 100 percent owned subsidiary involved in mining and sale of asbestos.

ASARCO International is a selling agent for Lake Asbestos and is a 100 percent owned subsidiary. Apparently its primary sales are in Europe; it is unclear whether they sell elsewhere.

(f) Southern Peru Copper is a 51.5 percent owned corporation. ASARCO has the power to appoint six of thirteen directors in Southern Peru Copper. Six of the remaining seven directors are appointed by other shareholders in the corporation and the thirteenth director apparently is chosen by the twelve appointed by ASARCO and other shareholders. ASARCO is the largest single shareholder; it indicates that the remaining three shareholders, owning the remainder of the stock, refuse to participate in the company unless assured that they would have a way to assure that management would not be completely dominated by ASARCO. Each company is entitled to purchase output from the mine in proportion to its stock ownership. ASARCO, for example, would be entitled to purchase 51.5 percent of available copper for sale. The product of the mine is "blister copper", which is copper that has been smelted and is approximately 97 percent pure. Blister copper, however, is not marketable, and must be refined before it can be commercially marketed. This refining, in the case of copper sold to ASARCO, is done in the United States at ASARCO refineries. ASARCO originally owned the mining property, and required approximately 235 million dollars to put it into production. ASARCO and the remaining three shareholders obtained loans from the Export-Import Bank and outside financing to develop the mine. ASARCO hopes that ownership or partial ownership of Southern Peru Copper Corporation will assure it of a long-term supply of copper, since physically there is a long-term supply of copper. The supply is dependent upon the political climate in Peru in that the mine could be ex-propriated by the Peruvian government.

(g) M.I.M., which apparently is a holding company for Mount Isa Mines, is a 52.7 percent controlled subsidiary. The company owns a large mine in Australia which produces gold, silver, lead, copper and zinc. The company owns smelters and a refinery in Australia and a substantial part of their product is sold in Japan and Europe. Sales to ASARCO are extremely limited; apparently they amount to no more than a few thousand dollars per year.

(h) Neptune Mining is a 51.8 percent owned subsidiary. During the years in question the company was involved in gold mining in Nicaragua; subsequent to those years the gold mining had been discontinued but lead and copper is being mined. The output of Neptune Gold mining is in the form of concentrates which are sold to ASARCO and refined and smelted at ASARCO's plants.

(i) ASARCO Mexicana, S. A. is a 49 percent owned subsidiary and apparently conducts the same business in Mexico that ASARCO carries on in the United States. In the words of the witness for ASARCO, the two businesses are "parallel". The remaining 51 percent of the stock in the company is owned by a group of Mexican citizens and the remaining ownership is scattered so that ASARCO is the largest single stockholder in the company. Products from ASARCO Mexicana, S. A. are sold to ASARCO.

(j) Mexicana de Cobra S. A. owns the mineral lands upon which ASARCO Mexicana operates.

In addition to the foregoing inter-relationships, ASARCO itself provides services to its subsidiaries. Subsidiaries are subjected to a charge from ASARCO for management, which is apportioned on the basis of direct costs. The witness from ASARCO was unable to indicate how these costs were determined or apportioned. ASARCO in past times apparently has provided substantial financing to the subsidiaries, or some of them. During the period, loans were made to Federated Metals. In general, ASARCO pays offi-

cers' salaries for all companies; the officers in fact are employees of ASARCO. Generally there is a common employee retirement plan; however, Northern Peru's is separate so also is that of Enthone and Federated Metals. ASARCO Mercantile had *no* employees of its own nor did International Metals.

ASARCO has a single required source for insurance; it has an arrangement to purchase insurance through a broker located at or near its headquarters building, and receives favorable rates because of its volume of purchase of insurance for itself and its subsidiaries. ASARCO maintains financial records for most of the subsidiaries except Northern Peru, Lake Asbestos and possibly Enthone. However, even these companies receive technical advice and some accounting services, and services in connection with preparing consolidated financial records and tax returns, from ASARCO itself.

ASARCO provides legal services for all of the subsidiaries.

Finally, and perhaps most important for an enterprise active in the mining and development of metals, ASARCO provides exploration and development services for the subsidiaries through its own exploration and development department, or through the subsidiary exploration and development companies.

Taxpayer strenuously argues that all dealings between the various companies were conducted "at arm's length" (which is an extremely tenuous argument since in many instances one officer was dealing for both of the "negotiating" parties as the agent of both companies) or at least such transactions were conducted at fair or reasonable prices. The argument mixes the very essence of formulary apportionment, which is that where there are integrated, interdependent steps in the economic process carried on by a business enterprise; there is no logical or viable method

for accurately separating the profit attributable to one step in the economic process from other steps. Essentially, formulary apportionment is necessary because inherent difficulties or impossibilities are present in seeking to divide the profits of a company like ASARCO where producing, manufacturing, and marketing are conducted by the same company but take place in different states. The argument for taxpayer is not strengthened by considering whether each of the separate manufacturing processes or steps could be conducted entirely separate from the remaining steps; if this took place, the Commission would not be attempting to measure a tax due from ASARCO and the unitary corporations with the strengths and weaknesses of an integrated operation that may commence in Peru and end in sale of products in Europe; the Commission would be faced with an entirely different taxpayer. We conclude that any attempt to separate out the profits of integrated steps of a business enterprise is unrealistic and futile. The problem is not merely one of measurement of what a component part might make if it were operated as a separate business; it is measurement of an integrated business enterprise.

The final major issue presented is whether income received by taxpayer in the form of dividends is properly apportioned as business income on the basis of the factors prescribed by § 63-3027, *Idaho Code,* or whether such income should be allocated to taxpayer's commercial domicile or some other state in its entirety.

The controversy seems to hinge on two questions:

1. Under § 63-3027, *Idaho Code,* is the income properly classified as "business income" or "nonbusiness income".

2. If the income in question is properly classified as "business income" does apportionment of such income offend the United States Constitution.

We find that the dividend income in question constitutes business income within the meaning of § 63-3027(a)(1), *Idaho Code.* "Business income" is defined as:

> ". . . income arising from transactions and activity in the regular course of taxpayers' regular business and includes income from the acquisition, management, or disposition of tangible and intangible property when such acquisition, management, or disposition constitutes integral or ncessary parts of the taxpayers' business operations. Gains or losses and dividend and interest income from stock and securities of any foreign or domestic corporation shall be presumed to be income from intangible property, the acquisition, management, or disposition of which constitute an integral part of the taxpayers' trade or business; such presumption may only be overcome by clear and convincing evidence to the contrary."

It seems clear that § 63-3027, *Idaho Code,* does not provide for automatic allocation to commercial domicile of all dividends, and provides only for allocation of dividends when they constitute "nonbusiness income".

> "Rents and royalties from real or tangible personal property, capital gains, interest, dividends, or patent or copyright royalties, *to the extent that they constitute nonbusiness income,* shall be allocated . . ." § 63-3027(d), *Idaho Code.*

(For the year 1968, the last sentence of § 63-3027(a)(1) reads:

> "Gains or losses and dividend and interest income from stock and securities of any foreign or domestic corporation in which the taxpayer owns or has the right to acquire, directly or indirectly, more than five per cent (5%) of the voting stock shall be presumed to be income from intangible property, the acquisition, management, or disposition of which constitute an integral part of the taxpayers' trade or business, such presumption may only be overcome by clear and convincing evidence to the contrary."

The change does not appear to be material in the present controversy since in all cases taxpayer owned 5 percent or more of the voting stock of the subsidiaries in question.)

Taxpayer has not shown by clear and convincing evidence that the acquisition, management, or disposition of the dividend paying subsidiaries in question does not constitute an integral part of its trade or business, and we find that the dividend income was business income.

The legislature has provided that as to income from dividends or capital gains on stocks, such income is presumed to be business income unless such presumption is overcome with clear and convincing evidence to the contrary. We do not believe by such provision the legislature intended to change the general principle that in situations such as the present the taxpayer must carry the burden of proof. It cannot be inferred that since the taxpayer must establish dividend income as nonbusiness income by clear and convincing evidence, that the Commission establish that other categories of income are business income. We think instead that the legislature only meant to provide a different standard of proof for the taxpayer in the case of dividend income and capital gains on stock.

Passing to the second question we see presented by this controversy, we do not believe that treating the income in question as business income offends the United States Constitution. If dividend income is to be taxed, there would seem to be two alternatives. The income can be treated as being earned at the "commercial domicile" of the corporation. The effect of such treatment is to arbitrarily assign to the state of commercial domicile one of the largest categories of income received by a large multistate taxpayer.

The concept of taxing all dividend income at the taxpayer's commercial domicile is a remnant of a fiction developed at an earlier date that the "situs" of an intangible was at a corporation's commercial domicile, which was very emphatically rejected by the Idaho Supreme Court in *John Hancock Mutual Life Insurance Co. vs. Neil,* 79 Idaho 385; and in *Futura Corporation vs. State Tax Commission,* 92 Idaho 288. The Supreme Court of the United States itself has not given support in its more recent decisions to the automatic assignment of intangible income to a taxpayer's commercial domicile, and we know of no case decided by the United States Supreme Court holding that income from intangibles must be assigned to the taxpayer's commercial domicile and cannot be assigned to other states. If a taxpayer has 10 percent of its assets, and its commercial domicile in state A, and 90 percent of its assets in state B, it is at least as reasonable to assume that 90 percent of its intangibles should be assigned to state B and 10 percent of its intangibles should be assigned to state A, as it is to automatically assume that all intangibles are held in state A. In fact, the key characteristic of an intangible is that is [sic] has no physical existence and has no physical location.

Whatever may be proper in the case of a taxpayer conducting a separate and distinct business operation involving investments and receipt of dividends, we think that where intangibles, or an investment in subsidiaries, is used as an integral and necessary part of the conduct of a taxpayer's trade or business the income is business income.

Finally, taxpayer contends that because the audit was in part conducted by the Multistate Tax Commission the proposed assessment is therefore invalid. Taxpayer does not further expound upon this principle in its brief and we are unable to follow the argument. We suppose the constitutionality is questioned because it is a compact between two or more states and because as might seem to be required by Article 1, Section 3 of the United States Constitution, consent by Congress has not been given. The argument has not been briefed by taxpayer or the staff, nor are we convinced that this Commission is the proper tribunal to determine the constitutionality of statutes duly enacted by the state legislature. However, we need not face that question; even assuming the compact be unconstitutional, it would by no means follow that the Commission could not utilize the fruits of an audit conducted by Multistate Tax Commission personnel.

WHEREFORE, the State Tax Commission hereby ORDERS that the Notice of Deficiency Determination dated September 14, 1971, and amended March 27, 1973, as herein modified, and which modification is shown on Exhibit "A" attached hereto, be hereby APPROVED, AFFIRMED and MADE FINAL.

DATED this 2nd day of July, 1974.

IDAHO STATE TAX COMMISSION

/s/ DON G. LOVELAND
Chairman

Orig: File
cerr: Taxpayer (R.R. #11,551)

(Certificate Omitted in Printing)

APPENDIX B

IN THE SUPREME COURT OF THE STATE OF IDAHO

No. 12198

AMERICAN SMELTING AND REFINING COMPANY,
Plaintiff-Respondent,

v.

IDAHO STATE TAX COMMISSION,
Defendant-Appellant.

REMITTITUR

Justice Bakes announced the decision in this cause March 12, 1969, to the effect that the judgment of the District Court of the Fourth Judicial District of the State of Idaho, Ada County, is reversed and remanded for further proceedings as set forth in the opinion.

IT IS NOW THEREFORE SO ORDERED.

I, R. H. Young, Clerk of the Supreme Court of the State of Idaho, do hereby certify that the attached and foregoing is a true and correct copy of the opinion filed in the above entitled cause April 3, 1979, and now of record in my office.

WITNESS My hand and the seal of this Court April 3, 1979.

R. H. Young, Clerk

/s/ By: JUDY E. CIZMISH
Deputy Clerk

APPENDIX C

IN THE DISTRICT COURT OF THE FOURTH JUDICIAL DISTRICT OF THE STATE OF IDAHO, IN AND FOR THE COUNTY OF ADA

CASE No. 53182

AMERICAN SMELTING & REFINING CO., *Appellant,*

vs.

IDAHO STATE TAX COMMISSION, *Appellee.*

AMENDED NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

The previous Notice of Appeal filed on May 23, 1979, is hereby amended to read:

NOTICE IS HEREBY given that American Smelting and Refining Company (ASARCO), the above-named appellant, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Idaho entered on March 12, 1979, reversing the judgment of the District Court for the Fourth Judicial District in and for the County of Ada in case No. 53182 entered on November 14, 1975.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

DATED this 29th day of May, 1979.

/s/ PHILIP E. PETERSON
Counsel for Appellant

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Counsel for Appellant

(Certificate of Service Omitted in Printing)

IN THE SUPREME COURT OF THE STATE OF IDAHO

No. 12198

AMERICAN SMELTING & REFINING CO., *Appellant,*

vs.

IDAHO STATE TAX COMMISSION, *Appellee.*

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APPENDIX D

Idaho Code § 63-3027

63-3027. COMPUTING TAXABLE INCOME OF NONRESIDENT PERSONS AND ANY CORPORATIONS.—The Idaho taxable income of a nonresident person with business situs in this state or any corporation with a business situs in this state shall be computed and taxed in accordance with the rules set forth in this section:

(a) As used in this section, unless the context otherwise requires:

(1) "Business income" means income arising from transactions and activity in the regular course of the taxpayers' trade or business and includes income from the acquisition, management, or disposition of tangible and intangible property when such acquisition, management, or disposition constitute integral or necessary parts of the taxpayers' trade or business operations. Gains or losses and dividend and interest income from stock and securities of any foreign or domestic corporation [in which the taxpayer owns or has the right to acquire, directly or indirectly, more than five per cent (5%) of the voting stock] shall be presumed to be income from intangible property, the acquisition, management, or disposition of which constitute an integral part of the taxpayers' trade or business; such presumption may only be overcome by clear and convincing evidence to the contrary.

(2) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(3) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(4) "Nonbusiness income" means all income other than business income.

(5) "Sales" means all gross receipts of the taxpayer not allocated under subsections (d) through (h) of this section.

(6) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(b) Any taxpayer having income from business activity which is taxable both within and without this state shall allocate and apportion such net income as provided in this section.

(c) For purposes of allocation and apportionment of income under this section, a taxpayer is taxable in another state if:

(1) In that state he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or

(2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

(d) Rents and royalties from real or tangible personal property, capital gains interest, dividends, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in subsection (e) through (h) of this section.

(e)(1) Net rents and royalties from real property located in this state are allocable to this state.

(2) Net rents and royalties from tangible personal property are allocable to this state:

(i) If and to the extent that the property is utilized in this state, or

(ii) in their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(3) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

(f)(1) Capital gains and losses from sales of real property located in this state are allocable to this state.

(2) Capital gains and losses from sales of tangible personal property are allocable to this state if:

(i) the property had a situs in this state at the time of the sale, or

(ii) the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(3) Capital gains and losses from sales of intangible personal property are allocable to this state if

the taxpayer's commercial domicile is in this state, unless such gains and losses constitute business income as defined in this section.

(g) Interest and dividends are allocable to this state if the taxpayer's commercial domicile is in this state unless such interest or dividends constitute business income as defined in this section.

(h)(1) Patent and copyright royalties are allocable to this state:

(i) if and to the extent that the patent or copyright is utilized by the payer in this state, or

(ii) if and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(2) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patent product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(3) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

(i) All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three (3).

(j) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

(k) Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight (8) times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

(l) The average value of property shall be determined by averaging the values at the beginning and ending of the tax period, but the [tax collector] *state tax commission* may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(m) The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the tax period.

(n) Compensation is paid in this state if:

(1) the individual's service is performed entirely within the state; or

(2) the individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

(3) some of the service is performed in the state and

(i) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or

(ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

(o) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

(p) Sales of tangible personal property are in this state if:

(1) the property is delivered or shipped to a purchaser other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale, or

(2) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and

(i) the purchaser is the United States government or

(ii) the taxpayer is not taxable in the state of the purchaser.

(q) Sales, other than sales of tangible property, are in this state, if:

(1) the income-producing activity is performed in this state; or (2) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

(r) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the [tax collector] *state tax commission* may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(1) separate accounting, provided that only that portion of general expenses clearly identifiable with Idaho business operations shall be allowed as a deduction;

(2) the exclusion of any one or more of the factors;

(3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

(s) For purposes of this section a parent and subsidiary corporation may, when necessary to accurately reflect income, be considered a single corporation.

(t) In computing the taxable income of a part-year or nonresident individual, trust or estate, the [optional standard deduction as defined in section 141 of] *stand-*

ard deductions as allowed by the Internal Revenue Code, if applicable, the exemptions as defined in section 151 of the Internal Revenue Code, and the Federal Income Tax deduction shall all be allowed in the proportion that the adjusted gross income of the taxpayer from Idaho sources bears to the total adjusted gross income from all sources before any deductions therefrom. The adjusted gross income, as used in this subsection, shall mean adjusted gross income as defined in section 62 of the Internal Revenue Code with adjustments for necessary additions and subtractions of income under this act.

SECTION 10. That Section 63-3031, Idaho Code, be, and the same is hereby amended to read as follows:

(Bracketed material deleted in 1969 pursuant to Section 9, Chapter 19, Session Laws of 1969.)

APPENDIX E

DIVIDENDS

	1968	1969	1970
UNITIZED			
Federated Metals of Canada	$ None	$ None	$ None
ASARCO	12,500	15,000	140,000
Mercantile Enthone, Inc.	340,000	400,000	940,000
Int'l. Inc.	50,000	200,000	
Lone Star Lead	80,000	80,000	160,000
No. Peru Mining Corp.	1,750,000	2,450,000	1,750,000
Compania American Smelting	15,687	26,385	
Lake Asbestos of Quebec, Ltd.	1,120,670	2,525,000	2,475,000
ASARCO Int'l. Corp.	70,000	80,000	135,000
So. Peru Copper Corp.	25,787,904	32,234,880	18,132,120
M.I.M. Holdings, Ltd.	9,661,070	20,466,130	33,647,396
ASARCO Mexicana, S.A.	1,882,918	1,882,918	1,882,918
General Cable	5,818,308	5,333,449	2,100,763
Revere Copper	2,814,444	2,814,444	2,345,370
Hecla Mining	91,729	46,242	11,561
Kennecott Copper Corp.	243,908	285,490	283,280
Phelps Dodge	269,850	300,690	323,820
Cia Minera de San Asidro y Aneyas, S.A.	50,557	—0—	—0—
Cia. Metalurgia Mex.	337,500	300,000	330,000
Japan Metal Finishing	8,454	6,081	11,383
Zinc Ind. S.A.	131,527	40,993	86,359
Pernix Enthone, S.A.		24,126	
Apache Power	5,600	7,600	8,000
TOTALS	$50,542,626*	$69,519,428*	$64,762,970*

* Total as shown in Federal Return for ASARCO

INTEREST

	1968	1969	1970
U.S. Government Securities	$1,182,989	$1,749,007	$2,239,199
United Park City Notes	12,000	12,000	12,000
Eisma Notes (sale of ASARCO Mexicana stock)	506,000	363,000	242,000
State and Local Bonds	330,489	672,635	111,023
Federated Metals of Canada, Ltd.		132,092	260,854
Revere Copper and Brass 5½% convertible debentures	1,251,965	1,251,965	1,251,965
N.Y. & Honduras Mining Co. Notes	24,559		
Bank Interest (fixed deposits)	63,306		
U.S. Reduction Corp. Notes		68,861	132,690
Sunshine Mining Company Notes		20,277	
Clayton Silver Mines Notes			25,375
Interest in connection with General Cable Sale			1,051,004
Neptune Gold Mining Note			4,673
Moran Notes (sale of Los Angeles plant)			56,250
Tax Refunds		17,579	329,296
Other Marketable Securities *	887,565	1,590,027	1,191,495
Other Interest Income	24,094	29,293	111,900
TOTALS	$4,282,917	$5,906,736	$7,019,724

See footnote on page 73

CAPITAL GAINS

	1968	1969	1970
Sale of M.I.M. Stock	$4,487,203	$2,230,370	$
Sale of Cia Minera de San Asidro y Aneyas stock	(645,817)		
Sale of Hecla Stock	3,753,251		141,098
Sale of U.S. Bonds (includes Federal Land Bank bonds)	118,906	81,406	
Sale of State & Local Bonds and notes	(1,723)	113,950	
Sale of Land, Buildings & Equipment**	16,232	98,089	51,952
Sale of U.S. Treasury Bonds			302,187
Sale of Connecticut 2¼% Bonds			16,844
Sale of General Cable Stock			45,482,303
Sale of Zinc Industrial, S.A.			406,207
TOTALS	$7,728,052*	$2,523,815*	$46,400,591*

* This is also reported on the ASARCO federal return.

** These represent Section 1245 recapture sales of property used in the business and are reported as ordinary income.

* *Other Marketable Securities:*			
Bankers Acceptances	$ 135,568	$ 360,833	$ 98,952
Time Certificates of Deposit	83,007	61,076	347,376
Commercial Paper Notes	668,990	1,168,118	746,402
	$ 887,565	$1,590,027	$1,192,760
Less amortization (time certificate deposits)			(1,265)
TOTAL ABOVE	$ 887,565	$1,590,027	$1,191,495